MOTION FILED

DEC 24 1997

(3)

No. 97-854

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

MICROSOFT CORPORATION, *et al.*,
Petitioners,
v.
DONNA VIZCAINO, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE* AND BRIEF *AMICI CURIAE* OF THE INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA, AMERICAN ELECTRONICS ASSOCIATION, AND SOFTWARE PUBLISHERS ASSOCIATION IN SUPPORT OF THE PETITION OF MICROSOFT CORPORATION

MARC A. PEARL
INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA

JEFFREY MCMILLEN
AMERICAN ELECTRONICS ASSOCIATION

MARK E. NEBERGALL
SOFTWARE PUBLISHERS ASSOCIATION

FREDRIC S. SINGERMAN *
DONALD L. ROSENTHAL
ERICA A. WATKINS
SEYFARTH, SHAW, FAIRWEATHER & GERALDSON
815 Connecticut Avenue, N.W.
Suite 500
Washington, D.C. 20006
(202) 463-2400
Counsel to Amici Curiae

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

25 pp

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

No. 97-854

MICROSOFT CORPORATION, *et al.*,
Petitioners,

v.

DONNA VIZCAINO, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

---

MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE*

Information Technology Association of America ("ITAA"), American Electronics Association ("AEA") and Software Publishers Association ("SPA") (collectively the "Employer Amici") respectfully move this Court, pursuant to Supreme Court Rule 37, to grant leave to file their brief, submitted herewith, as *Amici Curiae* in Support of the Petition for Writ of Certiorari filed by Microsoft Corporation ("Microsoft").

Pursuant to Supreme Court Rule 37.2, the Employer Amici have obtained the consent of Petitioner Microsoft Corporation to the filing of their Brief *Amici Curiae*. However, Stephen Strong, counsel for Respondents Donna Vizcaino, Jon R. Waite, Mark Stout, Geoffrey Culbert, Lesley Stuart, Thomas Morgan, Elizabeth Spokoiny and Larry Spokoiny, declined to consent to the filing of this Brief.

The Employer Amici are the leading trade associations in the information technology ("IT") and electronics industries. Information Technology Association of America ("ITAA") is a leading trade association of companies that create and market products and services associated with computers, communications and data. ITAA's 11,000 direct and affiliate members encompass systems integration, professional services, telecommunications, Internet, electronic commerce, client-servers and custom software manufacturing. IT products constitute the United States' number one export and the industry has a current workforce total of over 2.5 million individuals.

American Electronics Association ("AEA") members, which number over 3,000, are companies that conduct business in virtually every aspect of technology, including the fields of computer software and hardware, components, peripherals, semi-conductors and telecommunications. AEA estimates that 4.3 million people work in the industries it represents.

Software Publishers Association ("SPA") is the principal trade association of the personal computer software industry. Its membership of more than 1,200 companies represents 90% of all software publishers in the United States. SPA members sold more than $30 billion of software in 1995.

This case is of exceptional importance to the industries represented by the Employer Amici. Much of the work in the IT and electronics industries is project-oriented, demanding mobile, highly educated and highly compensated workers on a flexible, temporary or infreqent basis. Industry employers have met these demands by engaging workers in varying contractual relationships, including as independent contractors, temporary "contract" employees and leased employees.

In entering into relationships with skilled workers, members of the Employer Amici, like their counterparts in other industries, frequently enter into written contracts

governing pay and benefits. When the parties intend that the worker will not receive benefits as an employee, the contract will say so. Typically, these contracts also attempt to clarify the parties' respective employment tax and withholding obligations, so that the worker and the recipient of the services will treat the transaction consistently for tax purposes. That is exactly what Microsoft did, and it is very common practice throughout the IT and electronics industries.

The Ninth Circuit's holding in *Vizcaino v. Microsoft Corp.*, 120 F.3d 1006 (9th Cir. 1997), upsets the legitimate, settled contractual rights of businesses throughout all industries, and it does so retroactively. The IT and electronics industries are particularly at risk from the fallout of *Vizcaino*, because of their extensive use of highly skilled alternative workers, such as computer programmers, product testers and systems analysts, to work on specific projects and to provide specialized technological expertise. Further, the industries' common use of equity compensation to reward employees provides disgruntled workers with a windfall if they are able, at their discretion, to reconsider and repudiate the independent contractor characterization to which they themselves agreed.

Because of their role as leading trade associations in the eletctronics and IT industries, the Employer Amici have an understanding of the impact the *Vizcaino* decision will have on these industries nation-wide. The Employer Amici's Brief explains the critical role that alternative workers play in the IT and electronics industries and the United States as a whole, as well as the important reasons businesses and workers enter into alternative arrangements.

The Brief *Amici Curiae* also discusses the serious difficulty and uncertainty that businesses face when they classify highly skilled workers as employers or independent contractors and the extraordinary, retroactive burden that the ruling places on nearly every employer who misclassi-

fies workers. It also addresses the use of employee stock purchase plans in high technology industries. The Employer Amici believe that their Brief will serve to impress upon the Court the importance of this case to United States employers and the critical need for this Court to grant Microsoft's Petition for Writ of Certiorari.

This motion is timely filed pursuant to Supreme Court Rule 37.2.

For the foregoing reasons, the Employer Amici respectfully request that the Court grant them leave to file their Brief *Amici Curiae* in support of Microsoft's Petition for Writ of Certiorari.

Respectfully submitted,

MARC A. PEARL
INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA

JEFFREY MCMILLEN
AMERICAN ELECTRONICS ASSOCIATION

MARK E. NEBERGALL
SOFTWARE PUBLISHERS ASSOCIATION

FREDRIC S. SINGERMAN *
DONALD L. ROSENTHAL
ERICA A. WATKINS
SEYFARTH, SHAW, FAIRWEATHER & GERALDSON
815 Connecticut Avenue, N.W.
Suite 500
Washington, D.C. 20006
(202) 463-2400
Counsel to Amici Curiae

* Counsel of Record

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF THE *AMICI CURIAE*	1
SUMMARY OF ARGUMENTS	3
ARGUMENT	6
I. THE NINTH CIRCUIT OPINION UNDERMINES ALTERNATIVE WORK ARRANGEMENTS THAT BENEFIT BOTH BUSINESSES AND WORKERS	6
II. THE NINTH CIRCUIT OPINION IMPOSES A DRACONIAN PENALTY ON EMPLOYERS FOR WORKER MISCLASSIFICATION	9
III. THE NINTH CIRCUIT MISCONSTRUED THE ESPP	13
IV. THE NINTH CIRCUIT UTTERLY NEGATED WASHINGTON LAW	14
CONCLUSION	17

TABLE OF AUTHORITIES

FEDERAL CASES — Page

Boren v. Southwestern Bell Telephone Co., 933 F.2d 891 (10th Cir. 1991) 16
Cort v. Ash, 422 U.S. 66 (1975) 5, 14
Vizcaino v. Microsoft Corp., 120 F.3d 1006 (9th Cir. 1997) ..... *passim*

STATE CASES

Bill v. Gattavara, 209 P.2d 457 (Wash. 1949) 16
Corbray v. Stevenson, 656 P.2d 473 (Wash. 1982) 15
Daniel v. Pacific Northwest Bell Tele. Co., 580 P.2d 652 (Wash. App. 1978), *review denied*, 90 Wash. 2d 1025 (Wash. 1978) 16, 17
Hatley v. West, 445 P.2d 208 (Wash. 1968) 16
Mayer v. Pierce County Med. Bureau, Inc., 909 P.2d 1323 (Wash. 1995) 15
Seattle-First National Bank v. Earl, 565 P.2d 1215 (Wash. 1997) 15
Tanner Electric Cooperative v. Puget Sound & Light Co., 911 P.2d 1301 (Wash. 1995) 15
Wagner v. Wagner, 621 P.2d 1279 (Wash. 1980) 15
Weyerhaueser Timber Co. v. Skaglund, 132 P.2d 724 (Wash. 1942) 15, 16

FEDERAL STATUTES

26 U.S.C.A. § 423 (1988) 5, 13
26 U.S.C.A. § 3509 (West Supp. 1997) 11
29 U.S.C.A. §§ 1001-1461 (1985) 14
Section 269 of the Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248, 96 Stat. 552 11
Section 530 of the Revenue Act of 1978, P.L. 95-600, 92 Stat. 2885 ..... 10, 11

JOURNALS

Katherine Abraham & Susan Taylor, *Firms' Use of Outside Contractors: Theory and Evidence*, 14 J. of Lab. Econ. 394 (1996) 7, 8

TABLE OF AUTHORITIES—Continued

Page

Lewis Segal and Daniel Sullivan, *The Growth of Temporary Services Work*, Federal Reserve Bank of Chicago Working Paper Series, WP-96-26 (Dec. 1996) 8

Sandra Slaughter & Ang Sun, *Employment Outsourcing in Information Systems*, 39 Ass'n for Computing Machinery 47 (July 1996) 8

MISCELLANEOUS

Bureau of Labor Statistics, U.S. Dep't of Labor, news release, U.S.D.L. 97-422, *Contingent and Alternative Employment Arrangements, February 1997, Labor Force Statistics from the Current Population Survey* (Dec. 2, 1997) 4, 6, 7, 8

143 Cong. Rec. S2429 (daily ed. Mar. 18, 1997) 12

Hearing on Small Business Taxation Proposals Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance, 105th Cong. (1997) (statement of Donald C. Lubick, Acting Ass't Sec'y, U.S. Dep't of Treas.) 11

Internal Revenue Service, U.S. Dep't of Treas., *Internal Revenue Service Training Materials on Worker Classifications for Tax Purposes as Independent Contractors or Employees* (Training 3320-102 rev. 10-96), TPDS 842381, issued March 4, 1997 ..... 9, 10

23 Pens. & Ben. Rep. (BNA) 1343 (May 20, 1996) 11

24 Pens. & Ben. Rep. (BNA) 1104 (May 5, 1997) .. 12

Rev. Rul. 87-41, 1987-1 C.B. 296 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

No. 97-854

MICROSOFT CORPORATION, *et al.*,
Petitioners,

v.

DONNA VIZCAINO, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

---

BRIEF *AMICI CURIAE* OF THE INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA, AMERICAN ELECTRONICS ASSOCIATION, AND SOFTWARE PUBLISHERS ASSOCIATION IN SUPPORT OF THE PETITION OF MICROSOFT CORPORATION

INTEREST OF THE *AMICI CURIAE*

Information Technology Association of America ("ITAA"), American Electronics Association ("AEA") and Software Publishers Association ("SPA") (collectively the "Employer Amici") respectfully submit this Brief *Amici Curiae*[1] in support of the Petition for Writ of Certiorari filed by Microsoft Corporation ("Microsoft").

ITAA is a leading trade association of the companies which create and market products and services associated

---

[1] This brief was authored in whole by counsel for the Employer Amici, Seyfarth, Shaw, Fairweather & Geraldson.

with computers, communications and data. ITAA's 11,000 direct and affiliate members encompass systems integration, professional services, telecommunications, Internet, electronic commerce, client-servers and custom software manufacturing. The information technology ("IT") industry's workforce currently totals over 2.5 million individuals, ten times that of the basic steel industry, and three times that of the automotive industry. IT is our country's number one export.

AEA is a leading trade association of the electronics and IT industries, with over 3,000 members. AEA members include companies doing business in virtually every aspect of technology, including the fields of computer software and hardware, components, peripherals, semiconductors and telecommunications. Its members range in size from large, well-known corporations to small start-up ventures. AEA estimates that 4.3 million people work in the industries it represents.

SPA is the leading trade association of the personal computer software industry, with membership of more than 1,200 companies, representing 90% of all software publishers in the United States. Its members range in size from large, well-known companies to hundreds of smaller companies, all of which develop and market business, consumer, and education software. SPA members sold more than $30 billion of software in 1995.

This case is of exceptional importance to the industries represented by the Employer Amici. The IT and electronics industries are growing at a very rapid pace and in some areas production demand outstrips the supply of available workers. Much of the work is project-oriented, demanding mobile, highly educated and highly compensated workers on a flexible, temporary or infrequent basis. Industry employers have met these demands by engaging workers in varying contractual relationships, including as independent contractors, temporary "contract" employees and leased employees.

In entering into relationships with skilled workers, members of the Employer Amici, like their counterparts in other industries, frequently enter into written contracts governing pay and benefits. If the parties intend that the worker will not receive benefits as an employee, the contract will say so. Typically, these contracts also clarify the parties' respective employment tax and withholding obligations, so that the worker and the recipient of the services (and the leasing company, if there is one) will treat the transaction consistently for tax purposes. That is exactly what Microsoft did, and it is very common practice throughout the IT and electronics industries. Reclassification of a worker, however, must not change the basic terms of their contract—what services the worker will provide and what he or she will be paid.

The Ninth Circuit's holding in *Vizcaino v. Microsoft Corp.*, 120 F.3d 1006 (9th Cir. 1997), upsets the legitimate, settled contractual rights of businesses throughout all industries, and it does so retroactively. The IT and electronics industries are particularly at risk from the fallout of *Vizcaino,* because of their extensive use of highly skilled alternative workers, such as computer programmers, product testers and systems analysts, to work on specific projects and to provide specialized technological expertise. Further, the industries' common use of equity compensation to reward employees provides disgruntled workers a financial brass ring to aim for in second-guessing the independent contractor characterization that they themselves agreed to.

SUMMARY OF ARGUMENTS

This case is important because the non-traditional workforce is a large and important segment of the United States economy. Independent contractors, temporary help agency workers and other "alternative workers" comprise 10% of the nation's workforce.[2] Independent contractors

[2] The phrase "alternative work" refers to work outside of the traditional employer-employee relationship. It encompasses inde-

alone comprise 6.7% of the workforce. The determination of whether a worker is an employee or an indpendent contractor—or whether a temporary help agency worker is an employee of the agency or the service recipient—is necessarily a factual determination, and the right answer is often a very difficult and uncertain one. Where the employer and worker have selected the wrong characterization for tax purposes, they may face significant adverse consequences, including liability for back taxes, penalties and interest.

Vizcaino v. Microsoft Corp. imposes an additional, draconian penalty on employers who have misclassified workers, in the form of a retroactive award of benefits. In the guise of applying state law, the Ninth Circuit has created a doctrine of Federal common law that is openly hostile to non-traditional work arrangements. The doctrine is simple: An employer who has misclassified a worker as an independent contractor may be required to provide employee benefits to the worker *retroactively*, notwithstanding that the worker has agreed to the classification and has further agreed not to receive such benefits.

This doctrine has no basis in Federal law and is inimical to the approach to worker classification issues taken by Congress and the Internal Revenue Service ("IRS"). It will discourage employers from voluntarily correcting worker misclassifications, as Microsoft did, because doing so will be used as a club against them in subsequent litigation. It may also chill the development and use of alternative work arrangements going forward. Such non-

---

pendent contractors (regardless of whether they are otherwise identified as wage and salary workers), on-call workers, temporary help agency workers and workers provided by contract firms. The figures cited in the text are from the Bureau of Labor Statistics, U.S. Dep't of Labor, news release, U.S.D.L. 97-422, *Contingent and Alternative Employment Arrangements, February 1997, Labor Force Statistics from the Current Population Survey* (Dec. 2, 1997) (cited as "BLS"). The definitions used in the text follow the BLS definitions.

traditional work arrangements are, however, vital to American industry and beneficial to the workers who enter into them.

It is undisputed that any rights Microsoft's "freelancers" could have to participate in the corporation's Employee Stock Purchase Plan ("ESPP") must be found under contract law of the State of Washington. Yet the court's analysis utterly tramples the essential elements of Washington law governing contract formation and reformation. In disregarding the parties' expressed intent, the Ninth Circuit assigns to Microsoft an intent that ignores the fundamental purpose of equity compensation and unjustly enriches the freelancers who neither bargained for nor expected to receive ESPP benefits. In essence, the court has created a new private cause of action to enforce the tax provision relating to stock purchase plans, Section 423 of the Internal Revenue Code of 1986 ("Code"), 26 U.S.C.A. § 423 (1988), in violation of the principles espoused by this Court in *Cort v. Ash*, 422 U.S. 66 (1975).

Vizcaino v. Microsoft Corp. raises the question of whether a Federal court may ignore state law to impose a retroactive obligation on an employer to provide a benefit to a party, in the absence of a Federal law requirng such benefit to be provided, and in the face of a contract stating that such benefit will not be provided. The Ninth Circuit's decision imposes an enormous cost on businesses throughout the country that have made good faith efforts to comply with the complex and changing rules regarding worker classification. Unless the decision is reviewed and reversed, these businesses will face a flood of litigation, in which workers will challenge the independent contractor status that they themselves agreed to, in order to gain windfall benefits.

ARGUMENT

I. THE NINTH CIRCUIT OPINION UNDERMINES ALTERNATIVE WORK ARRANGEMENTS THAT BENEFIT BOTH BUSINESSES AND WORKERS.

Underlying the Ninth Circuit's opinion in *Vizcaino v. Microsoft Corp.* is a steadfast refusal to view the independent contractor agreements ("ICAs") entered into between Microsoft and the freelancers as truly bilateral agreements freely entered into by the parties. Instead, the court makes Microsoft solely responsible for classification of the freelancers as independent contractors. By doing so, the court converts an agreement and accompanying information sheet, each signed by the freelancer, each acknowledging that he or she is an independent contractor and is not entitled to benefits, into non-agreement "explanations" not binding upon the freelancers. *Vizcaino,* 120 F.3d at 1019.

The court's presumption appears to be based on a view of alternative workers as displaced clerical workers who work for low pay and no benefits and are forced to move from office to office on a daily basis. This caricature of the alternative work force is certainly not true of the freelancers at Microsoft; nor is it true in the United States work force as a whole. Microsoft's freelancers were apparently well-educated—performing services as software testers, production editors, proof readers, formatters and indexers—and often worked for periods exceeding two years. 120 F.3d at 1008.

About 10% of the American work force—over 12.5 million people—are actively employed in alternative work arrangements, mostly as independent contractors. BLS, Table A.[3] Independent contractors are significantly more

---

[3] The BLS includes as independent contractors persons identified as independent contractors, consultants and freelance workers, but excludes business owners such as shopkeepers and restauranteurs. BLS, Technical Notes.

likely than traditional employees to have graduated college and are more likely to be employed in managerial, sales, professional specialty or precision production occupations. BLS, Tables 4 & 8. Fewer than one-half of alternative workers are in contingent or temporary jobs expected to be of limited duration. BLS, Table A.

Most telling, however, is that the overwhelming majority of independent contractors, 83.6%, actually prefer an alternative work arrangement over a more traditional employment arrangement. BLS, Table 11.

Businesses and workers enter into non-traditional work arrangements for a number of very important reasons. Many businesses rely on temporary or contingent workers to meet short-term or cyclical production demands:

> Accommodating an uneven demand for the organization's products or services may entail a variety of costs, including costs associated with carrying more workers on the payroll than are needed during slow periods and/or costs associated with varying the size of the regular workforce. Some firms may be able to smooth the flow of in-house work by contracting out peak period tasks.

Katherine Abraham & Susan Taylor, *Firms' Use of Outside Contractors: Theory and Evidence,* 14 J. of Lab. Econ. 394, 397 (1996). This is particularly true in the IT and software industries, where businesses may need to "staff-up" rapidly as a specific project or program moves into production.

In IT and other high-technology industries, where the demand for certain skills outpaces supply, non-traditional work arrangements are particularly important:

> Volatility of information technology has the effect of rapidly making IS [information services] skills obsolete and creating IS skills shortages. Firms may outsource because they cannot find and recruit sufficient numbers of permanent employees with certain skills. Outsourcing can help address labor shortages be-

> cause temporary help agencies, part time work, and contract work may attract people into the labor pool who would not enter if they had to work as permanent employees.

Sandra Slaughter & Ang Sun, *Employment Outsourcing in Information Systems,* 39 Ass'n for Computing Machinery 47 (July 1996).

Many businesses turn to alternative work arrangements because they do not have the technical expertise to hire, train or supervise workers with highly specialized skills. Where a business does not have sufficient need for a worker's highly specialized skills to keep the worker fully employed, both parties may prefer a non-traditional employment arrangement:

> For example, it may not be cost-effective for a small- or medium-sized organization to provide a full range of computer support activities in-house. Even if the firm could keep one or more full-time computer specialists busy, much of the day-to-day work likely would be rather routine. More complex problems would be outside the experience of the in-house staff. . . .

Abraham & Taylor, 14 Journal of Labor Economics at 399. *See also* Lewis Segal and Daniel Sullivan. *The Growth of Temporary Services Work,* Federal Reserve Bank of Chicago Working Paper Series, WP-96-26 (Dec. 1996).

An alternative work arrangement may also be extremely attractive from the worker's perspective. An independent contractor typically receives more of his or her compensation in cash than a traditional worker, BLS, Table 13, and will presumably make more efficient choices about his or her benefits than an employer would. Non-traditional workers may prefer the flexibility and control they exercise over their time and working conditions. For highly skilled workers, in particular, an alternative work arrange-

ment may provide a significantly better opportunity for professional development and exposure to a wider range of challenges than a traditional employment relationship.

Thus, the use of non-traditional work arrangements is driven by the needs of both businesses *and* their workers, and the contracts entered into between businesses and their alternative workers benefit both. The Ninth Circuit's opinion in *Vizcaino v. Microsoft Corp.* undermines these contracts by allocating the entire risk of worker mischaracterization to only one party, the employer, and by granting a windfall benefit to workers retroactively.

II. THE NINTH CIRCUIT OPINION IMPOSES A DRACONIAN PENALTY ON EMPLOYERS FOR WORKER MISCLASSICATION.

In effect, the Ninth Circuit's opinion imposes a retroactive, judicial sanction on Microsoft for misclassifying the freelancers as independent contractors for tax purposes that is without precedent in Federal statute or common law. This result ignores the real-world difficulties surrounding the proper characterization of workers in the marketplace. In its internal training manual, the IRS makes this point:

> [IRS] representatives are sometimes faced with the difficult task of making a determination of the classification of workers who provide products and services for others. . . . Businesses decide whether to hire independent contractors or employees depending on individual needs, customer expectations, and worker availability. **Either worker classification—independent contractor or employee—can be a valid and appropriate business choice.**

Internal Revenue Service, U.S. Dep't of Treas., *Internal Revenue Service Training Materials on Worker Classifications for Tax Purposes as Independent Contractors or Employees* (Training 3320-102 rev. 10-96), TPDS

842381, issued March 4, 1997 ("Training Manual"), at p. i (emphasis in original).

It can be extremely difficult to determine whether a particular worker is an employee or independent contractor. In 1987, the IRS promulgated a list of twenty factors that affect the decision. Rev. Rul. 87-41, 1987-1 C.B. 296. These factors include whether the recipient of the services has the right to require compliance with instructions about when, where and how the work is performed; whether the recipient provides training; how "integrated" the worker's services are in the recipient's business operations; whether a continuing relationship is intended; whether full-time work is required; etc. Obviously, some factors may indicate an employer-employee relationship, while others may indicate an independent contractor relationship. Worse, there is no clear guidance on the relative weight to be accorded to each factor.

Changes over time compound the complexity of the determination. As a worker's duties and the employer's business change, the worker's employment status may change as well. The relevant test governing employment status also changes over time. As the IRS Training Manual points out:

> Bear in mind also that information important in helping determine worker status may change over time because business relationships change over time. As a result, some of the twenty common law factors listed in Rev. Rul. 87-41 are no longer as relevant as they once were.

Training Manual at 2-4.

Congress recognized the complexity of worker classification issues and specifically addressed taxpayer concerns about the potential for large, retroactive employment tax assessments in such cases. Section 530 of the Revenue Act of 1978, P.L. 95-600, 92 Stat. 2885, bars the IRS from reclassifying workers as long as the employer

had a reasonable basis for the classification, including reliance on long-standing industry practice or a past audit in which the IRS did not challenge the classification of similarly-situated workers. It also bars the IRS from issuing additional regulations or revenue rulings on worker classification issues. Although Section 530 was initially passed as a one year "stop-gap" measure, it was extended on an interim basis several times, and was extended indefinitely by Section 269 of the Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248 ("TEFRA"), 96 Stat. 552. Congress also enacted a provision to mitigate retroactive employment tax liability where Section 530 relief is not available. 26 U.S.C.A. § 3509 (West Supp. 1997), as enacted by TERFA § 270.

The IRS has also attempted to respond to taxpayer concern about how the retroactive recharacterization of workers can affect businesses. In addition to implementing comprehensive training procedures for its agents (as evidenced by the Training Manual), the IRS recently promulgated a Classification Settlement Program ("CSP"), in order to address and relieve the possibility of draconian penalties from worker misclassification. 23 Pens. & Ben. Rep. (BNA) 1343 (May 20, 1996). Under the CSP:

> businesses that have misclassified their workers as independent contractors, have filed Form 1099 information returns, but have failed to meet the other requirements for relief under section 530 [of the Revenue Act of 1978], can settle the matter with IRS examiners by reclassifying their workers prospectively and paying only limited tax assessments. This eliminates the risk that tax assessments could be applied for multiple years.

Hearing on Small Business Taxation Proposals Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance, 105th Cong. (1997) (statement of

Donald C. Lubick, Acting Ass't Sec'y, U.S. Dep't of Treas.).

Nonetheless, the area remains an important concern to United States businesses. Senator Christopher S. Bond recently stated:

> As the chairman of the Small Business Committee, I have heard from countless small business owners who are caught in the environment of fear and confusion that now surrounds the classification of workers. This situation is stifling the entrepreneurial spirit of many small business owners who find that they do not have the flexibility to conduct their businesses in a manner that makes the best economic sense and that serves their personal and family goals.

143 Cong. Rec. S2429 (daily ed. Mar. 18, 1997).

There is no finding in this case that Microsoft acted in bad faith in characterizing the freelancers as independent contractors for tax purposes, or that the freelancers were somehow hoodwinked into agreeing to the characterization. Presumably, the parties agreed to the characterization because they legitimately, but mistakenly, believed it was accurate.

Nonetheless, when the IRS recharacterized the freelancers as employees rather than independent contractors, it triggered a specific set of statutory provisions imposing specific liability on Microsoft. The Ninth Circuit has gone far beyond the statutory liability associated with worker misclassification. At the same time that Congress and the IRS have made efforts to minimize the retroactive impact of worker misclassification, and to increase the predictability associated with worker classification issues,

---

[4] According to a recent report, there are currently 1,500 cases in the CSP. 24 Pens. & Ben. Rep. (BNA) 1104 (May 5, 1997). This provides a sense of how significant this case is, in that each of these 1,500 employers—the tip of the iceberg—may be open to a claim under the Ninth Circuit's theory in *Vizcaino*.

the Ninth Circuit has unfairly imposed enormous retroactive liability on Microsoft and increased the risks associated with worker misclassification for all employers.

If it stands, the court's ruling will result in a flood of litigation, in which workers will challenge the independent contractor status that they themselves agreed to, in order to gain windfall benefits. The workers will have the advantage of litigating a complex, subjective and shifting test of employment status.

III. THE NINTH CIRCUIT MISCONSTRUED THE ESPP.

Companies use stock purchase plans, like Microsoft's ESPP, as a means of instilling loyalty among employees and aligning the employees' financial interests with the interests of the company's shareholders. Further, stock purchase plans provide regular employees, who forgo flexibility and often work for lower hourly compensation, with an opportunity to participate in their employers' long-term growth as a reward for staying with the company. Many of the publicly-traded members of the Employer Amici have employee stock purchase plans.

The Ninth Circuit fundamentally misunderstood the nature of stock purchase plans when it imputed to Microsoft the intent to cover the freelancers under the ESPP. It is extremely unusual for a company to provide equity-based compensation to alternative workers, because such workers have not made the same type of commitment to the company as its regular employees. Alternative workers are not expected to contribute to the long-term growth of the company, so it makes little sense to reward them with equity compensation that is normally realized over a number of years.

The ESPP is subject to Section 423 of the Code, 26 U.S.C.A. § 423, which provides certain tax benefits to stock purchase plans that meet its requirements. Under Section 423, a stock purchase plan must be available to

all employees with certain exceptions—and *only* to employees. Consistent with the notion that it makes little sense to provide equity-based compensation to temporary workers, employees who have worked for an employer under two years and part-timers may be excluded from participation.

It is clear from the ICAs that Microsoft did not intend to cover the freelancers in the ESPP. Had Microsoft wanted or intended to provide equity compensation to the freelancers, it could have done so perfectly "legally" using non-qualified stock options or restricted stock (or other "shadow stock" techniques), and only the tax result would have differed from that provided by the ESPP. But, in fact, neither Microsoft nor the freelancers intended this.

The ESPP is not subject to the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C.A. §§ 1001-1461 (1985) ("ERISA"), so no enforceable participation requirement can be found under Federal law. What the Ninth Circuit has done in this case is provide the freelancers a private right of action to enforce the requirement in Section 423 of the Code that an employee stock purchase plan must cover all employees in order to receive favorable tax treatment. The Code itself provides no such cause of action, and this Court has made it clear that none may be inferred. *Cort v. Ash*, 422 U.S. 66 (1975).

IV. THE NINTH CIRCUIT UTTERLY NEGATED WASHINGTON LAW.

The Ninth Circuit's decision completely disregards Washington contract law by casting aside the unambiguous agreements between Microsoft and the freelancers and binding the two parties to a new agreement to which they never assented. The Supreme Court of Washington has repeatedly held that its courts cannot ignore a contract's express language:

> In construing a contract, a court must interpret it according to the intent of the parties as manifested by the words used. Courts can neither disregard contract language which the parties have employed nor revise the contract under a theory of construing it. An interpretation of a writing which gives effect to all its provisions is favored over one which renders some of the language meaningless or ineffective.

Wagner v. Wagner, 621 P.2d 1279, 1283 (Wash. 1980); *Mayer v. Pierce County Med. Bureau, Inc.,* 909 P.2d 1323 (Wash. 1995); *Corbray v. Stevenson,* 656 P.2d 473, 475 (Wash. 1982) ("[C]ontracts should be construed to reflect the intent of the parties . . . and courts, under the guise of construction or interpretation, should not make another or different contract for the parties.").

The ICAs state not only that the freelancers were independent contractors, but *further* that they agree to be responsible for their own "insurance and other benefits." *Vizcaino v. Microsoft Corp.,* 120 F.3d at 1019. The Ninth Circuit's reading of the contract ignores the requirement of Washington law that a contract be interpreted so that all provisions are meaningful and effective and consistent with the intent of the parties. *Wagner,* 621 P.2d at 1283; *Tanner Elec. Coop. v. Puget Sound & Light Co.,* 911 P.2d 1301, 1310 (Wash. 1995) ("The touchstone of contract interpretation is the parties' intent."); *Seattle-First National Bank v. Earl,* 565 P.2d 1215, 1218 (Wash. 1977).

Similarly, the court ignores Washington law on contract reformation. In reforming a contract, a court may not impose new obligations on a party; instead, the court may reform the contract only to reflect the parties' actual intent in making agreement. *Seattle-First,* 565 P.2d at 1218 (Wash. 1977) ("It is a longstanding rule that courts cannot, and ought not, make a contract for parties which they did not make for themselves or impose upon one party an obligation which was not assumed."); *Weyer-*

haueser Timber Co. v. Skaglund, 132 P.2d 724, 725-726 (Wash. 1942). ("Courts of equity do not rectify contracts. They simply rectify instruments purporting to have been made in pursuance of the terms of the contract.").

Finally, the Ninth Circuit's decision disregards the settled legal principle that an individual "should not be permitted unjustly to enrich himself at the expense of another." *Bill v. Gattavara,* 209 P.2d 457, 459 (Wash. 1949); *Hatley v. West,* 445 P.2d 208, 210 (Wash. 1968). The *Vizcaino* opinion stands this equitable principle on its head, by creating a contract that without question unjustly enriches the freelancers, each of whom received exactly what they agreed and expected to be paid for their services.

In declining to enforce the ICAs, the Ninth Circuit reaches a result directly contrary to the opinion of the Court of Appeals for the Tenth Circuit in *Boren v. Southwestern Bell Telephone Co.,* 933 F.2d 891 (10th Cir. 1991). Mr. Boren sought benefits as an employee, after working for Southwestern Bell for over 20 years pursuant to a series of agreements labeling him an independent contractor. The Tenth Circuit held that ERISA did not apply, because Brown was not a "participant" for ERISA jurisdictional purposes. In reviewing Boren's contract claim, however, the court held that Boren's agreement not to be considered an employee "prevent[s] him from claiming that the work he performed for Southwestern Bill constituted an acceptance of the company's unilateral offer of pension benefits. Clearly, neither party intended Mr. Boren's work to constitute such an acceptance." 933 F.2d at 894. Because the service contracts fixed the rights as between the parties, and the rights of third parties were not at issue, the court did not believe it necessary to determine whether Boren was actually an "employee" under common-law standards. *Id.*

The Court of Appeals of Washington reached precisely the same result in *Daniel v. Pacific Northwest Bell Tele.*

Co., 580 P.2d 652 (Wash. App. 1978), *review denied*, 90 Wash.2d 1025 (Wash. 1978).

CONCLUSION

For the reasons set forth above, we respectfully urge this Court to grant Microsoft's Petition for Writ of Certiorari.

Respectfully submitted,

MARC A. PEARL
INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA

JEFFREY MCMILLEN
AMERICAN ELECTRONICS ASSOCIATION

MARK E. NEBERGALL
SOFTWARE PUBLISHERS ASSOCIATION

FREDRIC S. SINGERMAN *
DONALD L. ROSENTHAL
ERICA A. WATKINS
SEYFARTH, SHAW, FAIRWEATHER & GERALDSON
815 Connecticut Avenue, N.W.
Suite 500
Washington, D.C. 20006
(202) 463-2400
Counsel to Amici Curiae

* Counsel of Record

Date: December 24, 1997